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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 239

JOSEPH MELTZER AND BERTHA MELTZER,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court of the United States (R. 10–15) is not reported. The opinion and the dissenting opinion of the Circuit Court of Appeals (R. 54–57) are reported at 154 F. 2d 776.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 15, 1946. (R. 58.) The petition for a writ of certiorari was filed on June 28, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer before 1941 made good his guaranty to another of a debt of $13,000 and in turn had a claim, through subrogation, against the principal debtor who by 1935 had lost all his property, was indebted to others, had substantially no credit, and was never able to make more than his living expenses since that time. The Tax Court found that the debt became worthless prior to 1941.

The question is whether Section 23 (k) (1) of the Internal Revenue Code, as retrospectively amended by Section 124 of the Revenue Act of 1942, prohibits the allowance of a deduction for the debt in 1941; and if so, whether the statute is unconstitutional.

STATUTES AND OTHER AUTHORITIES INVOLVED

The statutes and other authorities involved will be found in the Appendix, *infra*, pp. 16–19.

STATEMENT

The pertinent facts as found by the Tax Court (R. 10–13) may be summarized as follows:

The taxpayers, husband and wife, residents of New York City, filed a joint income tax return for the calendar year 1941 with the Collector of Internal Revenue for the Third District of New York. In the return, the taxpayer claimed a deduction from gross income of $13,000 as a bad debt which was disallowed by the Commissioner

in the determination of the deficiency. The taxpayer alleged before the Tax Court that the total amount of bad debts to which he was entitled as a deduction is $14,250. (R. 10.)

The taxpayer is a civil engineer with an office at 10 East 40th Street, New York City. He is associated in business with Herman M. Braloff. (R. 10.)

In 1929 Victor Mayper, a friend of the taxpayer, who was engaged in the designing and supervision of the construction of speculative industrial buildings and apartment houses, and who had had considerable income for a number of years from the practice of his profession, approached the taxpayer for a loan of $13,000. He stated that he would give a mortgage upon his residence in Douglaston, Long Island, as security for the loan. Mayper had built this residence in 1928 at a cost of approximately $50,000. There was at the time a first mortgage on the property of $20,000 and a second mortgage of $12,500, though these mortgages by 1929 may have been curtailed by the amount of a few hundred dollars. The taxpayer did not have the $13,000 to lend him but thought his associate in business, Braloff, might be willing to make the loan. Braloff had the money and made the loan. As security for the loan Mayper gave a personal bond to Braloff in the amount of $13,000, a note for the same amount bearing interest, and a third mortgage

upon his residence in Douglaston. The principal security of Braloff was, however, the taxpayer's bond in the sum of $13,000 guaranteeing the payment of the note and mortgage pursuant to its terms. (R. 10–11.)

When the time came for the payment of interest upon the note, Mayper was without funds to make any payment thereon. Braloff then requested the taxpayer to make good on his bond. After some negotiations between Braloff and the taxpayer, Braloff accepted $10,000 in cash from the taxpayer in satisfaction of his bond. The taxpayer then became subrogated to all of Braloff's rights in respect of the loan which he had made to Mayper, and in consequence then looked to Mayper for the payment of interest upon his note. By reason of the financial crash of 1929 and the subsequent decline in building operations, Mayper was not able to make any payment on the note. He did, however, give several notes to the taxpayer for the amount of the interest which was due but unpaid. (R. 11.)

Through his friendship for Mayper and for the purpose of tiding him over the financial depression, the taxpayer made additional advances to Mayper during the period from June 7, 1930, to November 25, 1932, in the aggregate sum of $4,250. (R. 12.)

Mayper's financial condition continuously deteriorated. He was not able to make any pay-

ments to the taxpayer upon his indebtedness to him. In 1935 the holder of the first mortgage on Mayper's residence at Douglaston foreclosed the first mortgage on the property, which was sold at a price of approximately $24,000. That amount was sufficient to pay off only the first mortgage and the arrears in taxes. Neither the holder of the second mortgage nor the taxpayer obtained deficiency judgments against Mayper. (R. 12.)

From 1935, after the foreclosure, until 1941, the financial condition of Mayper did not improve. After 1935 Mayper had no real property and no personal property except wearing apparel of less than $300 in value and office furniture of $50 in value. He had no credit whatever except a limited amount from a blueprinter. From 1935 on, his liabilities, including indebtedness to the taxpayer, were approximately $28,000 in excess of assets. (R. 12.)

In June, 1937, Mayper was put through supplementary proceedings in respect of a debt of $1,282.70. This debt was compromised by the payment of $310 by Mayper with money which he borrowed from another party. He made this compromise settlement in order to avoid bankruptcy proceedings. (R. 12.)

In 1940 the affairs of Mayper were poor as described by Mayper, and "sad" as related by him to the taxpayer, Joseph Meltzer. (R. 12.)

The taxpayer made many demands upon Mayper for at least installment payments upon his indebtedness to him. Mayper frankly stated that he was not in a position to make any payment until business improved. (R. 13.)

In 1941 the taxpayer made a final demand upon Mayper for the payment of his money, but Mayper stated that his financial condition had not improved—that he was in no position to make payment. The taxpayer threatened to obtain a judgment against Mayper for the payment of his indebtedness, and Mayper told him that if he did it would simply force him into bankruptcy. He then was requested to submit to an examination by the taxpayer's attorney as to his financial condition. He readily submitted to such examination on December 18, 1941, and stated that besides having no assets of any material value, he owed others than the taxpayer approximately $7,500, and that by reason of priorities resulting from the war situation he did not expect that his financial condition would improve to enable him ever to make any payment upon his indebtedness to the taxpayer. Upon the basis of these facts the taxpayer claimed the deduction from his gross income for 1941 of the $13,000 which was disallowed by the Commissioner in the determination of the deficiency. (R. 13.)

The Tax Court found as an ultimate fact that the debt owed by Victor Mayper to the taxpayer

in the aggregate amount of $14,500[1] became worthless prior to 1941. (R. 13.)

Upon the basis of the foregoing facts the Tax Court, affirming the Commissioner's determination (R. 5–8), disallowed the claimed deduction for the bad debts in question on the ground that they became worthless prior to the taxable year 1941 (R. 13–15). Upon the taxpayer's petition for review (R. 17), the Circuit Court of Appeals—one judge dissenting—affirmed (R. 54–57).

ARGUMENT

There is no conflict of decisions, the decision of the court below is clearly correct and review by this Court is not required.

1. Section 124 (a) of the Revenue Act of 1942 amended Section 23 (k) (1) of the Internal Revenue Code to provide for a deduction of "debts which become worthless during the taxable year" in lieu of the former deduction of "debts ascertained to be worthless and charged off within the taxable year"; see Appendix, *infra,* p. 16. Section 124 (d) plainly provides that this amend-

[1] This amount comprises the sum of $10,000 cash which the taxpayer's partner Braloff accepted from the taxpayer in satisfaction of his bond guaranteeing payment of Mayper's note and mortgage (R. 11), plus the additional advances aggregating $4,250 which the taxpayer made from June 7, 1930, to November 25, 1932, to tide Mayper over the financial depression (R. 12). The taxpayer claimed a deduction of only $13,000 in his return with respect to Mayper's debt, but before the Tax Court he claimed a total deduction of $14,250. (R. 10.)

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ment is effective with respect to taxable years beginning after December 31, 1938. The court below properly held that under this statute the taxpayer was entitled to the deduction claimed for 1941 only if the debt became worthless in 1941, and that the Tax Court's finding that the debt became worthless prior to 1941, which was supported by substantial evidence, is conclusive on review. *Wilmington Co.* v. *Helvering,* 316 U. S. 164.

The taxpayer does not contend in this Court that the Tax Court's finding should be set aside. His sole contention is that the statute should be construed as the dissenting judge construed it, namely, that if the debt became worthless prior to 1939, it may still be deducted in the year it is later ascertained to be worthless under the law as it stood prior to the amendment and that the Tax Court should have found that it was first "ascertained" to be worthless in 1941, since ascertainment of worthlessness calls for a subjective rather than an objective test.

There is, however, no basis for this construction of the statute. Section 124 states in plain terms that it applies to "taxable years beginning after December 31, 1938." The taxable year here involved is 1941, and the law as amended is to be applied to all deductions for bad debts taken in that year. No exception is made as to debts which became worthless prior to 1939 but which were thereafter ascertained to be worthless. Other Circuit

Courts of Appeals have held that the statute is to be applied retroactively to all tax years beginning after 1938. *Cittadini* v. *Commissioner,* 139 F. 2d 29 (C. C. A. 4); *Fitzgerald* v. *Commissioner,* 154 F. 2d 1017 (C. C. A. 6), petition for a writ of certiorari pending, No. 245, this Term; *Redman* v. *Commissioner,* 155 F. 2d 319 (C. C. A. 1). In the *Cittadini* case, the court rejected the contention that there should be made an exception such as the taxpayer contends for in this case.

The taxpayer's contention that the legislative history shows that Congress did not intend the 1942 amendment to prohibit a deduction where to do so would impose a hardship such as would be imposed here (Br. 25–26) is not well taken.[2] Section 124 of the 1942 Act is so plain and unambiguous that there is no reason to turn to the Committee Reports or to other provisions of the law for interpretation. *Hecht* v. *Malley,* 265 U. S. 144, 151–152, 153. Even if these were examined, there is nothing in either to show or indicate that the lower court's interpretation and application of Section 124 herein is incorrect. If resort need be had to the Committee Reports,

[2] The taxpayer has not actually established any hardship. The record does not compel an inference that the debt was not ascertained to be worthless until 1941. While the Tax Court did not find to the contrary, since a finding as to that was not required, the evidence would clearly justify a finding that it was ascertained to be worthless before 1941. Ascertainment of worthlessness is not a purely subjective matter. See *Boehm* v. *Commissioner,* 326 U. S. 287.

however, the legislative history shows that "the fact of worthlessness, which is the proper criterion, will prevail."[3] It also shows that while ascertainment of worthlessness and charge-off on a taxpayer's books during the taxable year were prerequisite to the allowance of deductions for bad debts under the old law (H. Rep. No. 2333, 77th Cong., 2d Sess., p. 76 (Appendix, *infra*, p. 19).

> this section [of the 1942 Act] amends section 23 (k) of the Code [requiring ascertainment and charge-off] to allow a deduction for a debt which becomes worthless during the taxable year *regardless of the year in which the debt is ascertained to be worthless* or charged off. [Italics supplied.]

The 1942 retroactive amendment is clearly applicable to 1941 returns. The taxpayer's argument (Br. 26–28), based on the dissenting opinion below, is unsound and, if given effect, would make the amendatory provision meaningless. Quite clearly, if Congress had intended to except any debt deductions from the express terms thereof or to treat some of them differently, it would have placed such a limitation in Section 124. The amendment in that section was designed to remove the then existing inequities in

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[3] This is in harmony with this Court's holding in *Boehm* v. *Commissioner*, *supra*, 326 U. S. at 292, that "a loss, to be deductible * * * must have been sustained *in fact* during the taxable year." [Italics in original.]

the old law, particularly with respect to the uncertainties as to the time when debts became deductible. Congress accomplished this by substituting the test of "debts which become worthless within the taxable year" for the former requirement of "debts ascertained to be worthless and charged off," and by retroactively extending the limitation period on assessments and refunds to seven years. H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 44–45, par. 3 (A) and (B) (Appendix, *infra,* pp. 18–19). Obviously Congress could have extended the period retroactively for a much greater length of time but presumably it considered that any further extension would have been inadvisable from an administrative standpoint lest it upset many matters already settled and closed. Consequently, realizing that the needs of *all* taxpayers could not be met and that the limitation must be reasonably fixed, Congress deemed it advisable to make the amendment applicable only to taxable years beginning after December 31, 1938, and to extend the statute of limitations to seven years. Sections 124 (d) and 169 of the Revenue Act of 1942. This was fair to both the taxpayers and the Government.

2. The majority opinion of the court below properly held that since deductions are a matter of legislative grace there can be no doubt of the power of Congress to have made the 1942 amendment effective retroactively so as to apply to the taxable year 1941. (R. 56.)

The taxpayer argues that if the position set forth in the dissenting opinion below is not adopted by this Court, the provisions of the 1942 Act applying retrospectively to all taxable years after 1938 should be declared unconstitutional as being retroactive for an unreasonable length of time and harshly and oppressively depriving him of relief from the inequities of the prior law intended by Congress to have been remedied by the new law. (Pet. 8; Br. 26–28.)

In the first place, it is questionable whether any hardship has been imposed on the taxpayer by the change in the law. In any event, there is clearly no merit to these contentions. In plain terms, Section 124 (d) of the 1942 Act (Appendix, *infra*, p. 16) made the amendment applicable to all years subsequent to 1938, but in this case the period of retroactivity provided thereby extended back only approximately seven months to the time when the taxpayer's 1941 return was due to have been filed on March 15, 1942. The taxpayer filed his appeal with the Tax Court on April 13, 1944 (R. 1, 3), long after the enactment of the 1942 Act. He acquired no complete right to the deduction claimed under Section 23 (k) of the old law merely by filing his return before the passage of the 1942 Act. A taxpayer has no vested right to a deduction not allowed by law (*Cittadini* v. *Commissioner,* 139 F. 2d 29, 31 (C. C. A. 4)), and a suit is determined by the law in effect when judgment is rendered (*United States* v.

Heinszen & Co., 206 U. S. 370, 387, and authorities there cited).

Moreover, before the taxpayer's return was filed, hearings had been started on the prospective Revenue Bill of 1942 on March 3, 1942, when an elaborate statement was submitted by the then Secretary of the Treasury outlining the various provisions proposed to be enacted in the 1942 Act.[4] The hearings were thereafter continued before the appropriate House and Senate Committees until the Committee and Conference Reports were completed and the Bill was enacted into law on October 21, 1942, long before the Tax Court entered its decision herein on June 20, 1945. (R. 16.) Consequently, the taxpayer was put on notice "while the [1942] statute was in process of enactment" (*United States* v. *Hudson*, 299 U. S. 498, 500), and the amended law was in effect and therefore controlled the decision of the Tax Court when it was handed down. Accordingly, considering the circumstances herein, it cannot be said that the period of retroactivity fixed in the 1942 Act is unreasonable or that the Act's "retroactive application is so harsh and oppressive as to transgress the constitutional limitation" (*Welch* v. *Henry*, 305 U. S. 134, 147). Judicial approval has already been given to the retroactive application of the amendment as provided by Section 124 (d) of the 1942 Act. *Citta-*

[4] House Hearings on the Revenue Revision of 1942 before the Ways and Means Committee, March 3, 1942, Vol. 1, p. 2.

dini v. *Commissioner,* 139 F. 2d 29, 31 (C. C. A. 4); *Fitzgerald* v. *Commissioner, supra.*

It is settled that reasonable retroactivity of the Revenue Acts is valid. *Milliken* v. *United States,* 283 U. S. 15, 23; *Cooper* v. *United States,* 280 U. S. 409; *Brushaber* v. *Union Pac. R. R.,* 240 U. S. 1; *Hecht* v. *Malley,* 265 U. S. 144; *Wilgard Realty Co.* v. *Commissioner,* 127 F. 2d 514 (C. C. A. 2), certiorari denied, 317 U. S. 655. They may properly be applied retrospectively when that purpose plainly appears, as herein. *Brewster* v. *Gage,* 280 U. S. 327, 337. This Court has never held a federal income tax statute invalid because of retroactivity.

Since deductions are matters of legislative grace (*New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440) and may be changed or eliminated altogether, the taxpayer's situation in this respect is no different from what it would be if the amendment had been enacted in 1940; surely it could not be contended that such a statute would be invalid. *Corliss* v. *Bowers,* 281 U. S. 376; *Reinecke* v. *Smith,* 289 U. S. 172; and *Burnet* v. *Wells,* 289 U. S. 670, involved provisions taxing the income of certain trusts to the settlor and sustained their application to trusts created when there was no such provision in the law. The situation in *Cooper* v. *United States,* 280 U. S. 409, was similar. *A fortiori,* a taxpayer has no vested right in a prospective deduction.

In view of the foregoing it is clear that the bad debts in question did not become worthless within the taxable year 1941, and that therefore the taxpayers are not entitled to a deduction therefor for that year under the provisions of Section 23 (k) (1) of the Internal Revenue Code, as amended, and Section 19.23 (k)–1 of Treasury Regulations 103, as amended.

CONCLUSION

The petition presents no conflict of decisions and shows no other reason for certiorari. The petition should therefore be denied.

Respectfully submitted.

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JULY 1946.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME [as originally enacted]

In computing net income there shall be allowed as deductions:

* * * * *

(k) *Bad Debts.*—

(1) *General Rule.*—Debts ascertained to be worthless and charged off within the taxable year * * *.

* * * * *

(26 U. S. C., Sec. 23.)

Revenue Act of 1942, c. 619, 56 Stat. 798: [5]

SEC. 124. DEDUCTION FOR BAD DEBTS, ETC.

(a) *General Rule.*—Section 23 (k) (relating to bad debts and securities becoming worthless) is amended to read as follows:

"(k) *Bad Debts.*—

"(1) *General Rule.*—Debts which become worthless within the taxable year; * * *

* * * * *

(d) *Effective Date of Amendments.*—The amendments made by this section adding the last sentence of section 23 (k) (1) and adding section 23 (k) (4) shall be effective only with respect to taxable years beginning after December 31, 1942; the amendment inserting section 23 (k) (5) and amendments related thereto shall be applicable only with respect to taxable years beginning after December 31, 1941; and the other amendments made by this

[5] Further amendments to Section 23 (k) (1) were made by Section 113 of the Revenue Act of 1943, c. 63, 58 Stat. 21 which are not material here.

section shall be effective with respect to taxable years beginning after December 31, 1938.

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (k)–1 [As amended by T. D. 5234, 1943 Cum. Bull. 119]. *Bad Debts.*—(*a*) Bad debts may be treated in either of two ways—

(1) By a deduction from income in respect of debts which become worthless in whole or in part, or

* * * * *

(*b*) If, from all the surrounding and attending circumstances, the Commissioner is satisfied that a debt is partially worthless, the amount which has become worthless during the taxable year shall be allowed as a deduction in computing net income. * * * If a debt becomes wholly worthless during the taxable year, the amount thereof which has not been allowed as a deduction for any prior taxable year shall be allowed as a deduction for the taxable year. * * * In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. * * *

Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bank-

ruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. * * *

H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 44–45, 76:

3. *Treatment of Bad Debts.*—The bill makes substantial changes in the treatment of bad debts. These changes are designed to remove existing inequities and to improve the procedure through which bad-debt deductions are taken. It also makes certain the treatment which is to be accorded to the recovery of bad debts and previously paid taxes.

(A) *Elimination of charge-off requirements.*—In order to get a deduction for a bad debt under the present law two requirements must be met: (*a*) the debt must be ascertained to be worthless, and (*b*) it must be charged off during the taxable year.

These two requirements have caused considerable difficulty, particularly the requirement of a charge-off in cases where the taxpayer keeps inadequate records. In lieu of these two requirements, the bill substitutes the test of "debts which became worthless within the taxable year." Thus, whether or not the mechanics of the charge-off are fulfilled, the fact of worthlessness, which is the proper criterion, will prevail.

(B) *Longer statute of limitations for bad debts and worthless stock losses.*—Under the existing law, the taxpayer may be whipsawed out of a deduction for a bad debt because of the uncertainty as to the time at which the debt becomes worthless. Later evidence often discloses that present decisions as to the year in which a debt

becomes worthless are erroneous. For example, the taxpayer concludes that a debt has become bad and takes the deduction in that year, only to discover by later evidence that the debt actually became worthless three years previously. The statute of limitations having run on such previous year, this deduction is lost forever to the taxpayer. Conversely, where the debt actually became worthless in a year later than the year chosen by the taxpayer, the 3-year statute of limitations may operate against the Government.

To relieve this inequitable situation, the bill replaces the present 3-year statute of limitations in such cases with a 7-year statute, giving a considerably greater flexibility to the allowance of bad debt deductions in the proper year.

* * * * *

Section 119. Deduction for Bad Debts, Etc.—Under present law ascertainment of worthlessness and charge-off on the books of the taxpayer during the taxable year are prerequisites for the allowance of a deduction for a bad debt. This section amends section 23 (k) of the Code to allow a deduction for a debt which becomes worthless during the taxable year regardless of the year in which the debt is ascertained to be worthless or charged off. A similar amendment is made to section 204 (c) (6) of the Code with respect to deductions for bad debts allowed insurance companies other than life or mutual. These amendments are made retroactive so as to apply to all taxable years beginning after December 31, 1938.

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U. S. GOVERNMENT PRINTING OFFICE: 1946